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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955.

No. 194

ADELINE KIRSCHENMANN,

Petitioner,

vs.

HARRY C. WESTOVER, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA,

Respondent.

HENRY KIRSCHENMANN,

Petitioner,

vs.

HARRY C. WESTOVER, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTKICT OF CALIFORNIA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

LLEWELLYN A. LUCE,
937 Munsey Bldg.,
Washington, D.C.,
LLOYD G. RAINEY,
J. EVERETT BLUM,
139 South Beverly Drive,
Beverly Hills, California,
Counsel for Petitioners.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above cases on March 8, 1955.

Opinions Below.

The opinion of the District Court for the Southern District of California, Northern Division [R. 70-72] is reported at ..... Fed. Supp. ....., 42 A. F. T. R. 1271. The opinion of the Court of Appeals for the Ninth Circuit [R. 168-172] is reported at ..... F. 2d ....., ... A. F. T. R. ....., 1955 P-H, par. 72,492.

Jurisdiction.

The judgment of the Court of Appeals for the Ninth Circuit was made and entered on March 8, 1955 [R. 173] and a copy thereof is appended to this petition in the Appendix at pages 1 to 5. A petition for rehearing, filed within the time prescribed by law and rule of Court, was denied by the Court of Appeals for the Ninth Circuit on May 31, 1955 [R. 174]. The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

Question Presented.

Were payments made in 1944 by appellants to the guardian of their minor child pursuant to an agricultural lease entered into between petitioners and the guardian pursuant to an order of the Court having jurisdiction of the guardianship, deductible by petitioners as rent under Section 23(a)(1)(A) of the Internal Revenue Code, in computing their respective net incomes subject to income tax for said year 1944?

Statutes, Federal Rules and Regulations Invoked.

The following statute is involved herein.

Internal Revenue Code:

Section 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses—

(1) Trade or Business Expenses—

(A) In General.— * * *; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity * * *.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Section 29.23(a)-1. Business expenses.—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, * * *. Among the items included in business expenses are * * * rental for the use of business property.

Statement.

These cases involved federal incomes taxes with interest thereon for the taxable year ended December 31, 1944. The amount involved on each appeal is $9,501.00. Payments thereof were made on March 15, 1944; October 6, 1948, and March 7, 1949 [R. 5, 74]. Separate claims for refund were duly filed by each petitioner [R. 74, 75]. More than six months had elapsed between the date of

filing said claims for refund and the date of filing the complaints in the District Court [R. 10, 28, 30, 75]. Within the time provided in Section 3772 of the Internal Revenue Code, petitioners each brought an action on August 29, 1949, in the District Court for the recovery of the taxes and interest paid [R. 25]. Jurisdiction was conferred on the District Court by Section 1340 of the Judicial Code, as amended (Title 28, U. S. C., Sec. 1340).

These actions were consolidated for trial and disposition [R. 30]. They were submitted to the District Court on a written stipulation of facts, with exhibits attached [R. 30-70] and on oral testimony [R. 91-156]. The facts which were stipulated are as follows:

Petitioners at all times herein material were residents of the County of Kern, State of California, were citizens of the United States of America, and were married and living together [R. 4, 30, 74]. Petitioners duly filed their income tax returns for the taxable year ended December 31, 1944, and each duly paid the tax disclosed thereon in the sum of $33,874.06 to respondent in the manner and at the time required by law. Thereafter a deficiency assessment of income tax for said taxable year was made against each petitioner in the sum of $9,551.49, which amount, together with interest thereon in the sum of $2,040.35, was paid by each petitioner to respondent. The total amount paid by each petitioner to respondent as income tax and interest thereon for said year was the sum of $45,465.90 [R. 5, 30, 74].

On September 19, 1940, Margaret P. Osborne, lessor, leased to petitioner, Henry, lessee, for the term of five years, commencing on November 1, 1941, and ending on October 31, 1946, certain real property located in Kern

County, California [R. 30, 31] pursuant to a written lease, copy of which is attached to the stipulation of facts as Exhibit E [R. 35-40].

On August 25, 1943, petitioners, by written agreement, agreed to purchase said real property from Margaret P. Osborne for the sum of $32,000.00, payable $8,000.00 upon execution of the agreement and $8,000.00 one year, $8,000.00 two years, and $8,000.00 three years after the date of the agreement [R. 31]. A true copy of said agreement is attached to said stipulation as Exhibit F [R. 41-44].

On January 7, 1944, petitioners executed grant deeds on said real property to their daughter, Shirley May Kirschenmann, aged 12 [R. 32]. True copies of said deeds are attached to said stipulation as Exhibit G [R. 44-47].

Thereafter, Edward Kirschenmann was duly appointed guardian of the Estate of Shirley May Kirschenmann in appropriate proceedings in the Superior Court of the State of California, in and for the County of Kern [R. 6, 7, 27, 30].

Thereafter, and under order made by said Superior Court in said proceedings, said guardian executed a lease with petitioner, Henry Kirschenmann, whereby said property so deeded to Shirley May was leased to said petitioner under and by virtue of a written agricultural lease dated February 21, 1944. As rental for the use and occupancy of said land, lessee agreed to pay certain fractions, graduated according to market price of potatoes grown on said property [R. 7, 27, 30]. A true copy of said lease is attached to said stipulation as Exhibit H [R. 47-51].

Said petitioner, as lessee, entered upon said land and farmed the same and harvested potatoes thereon during the said year 1944. Under and by virtue of said lease the rental paid by said lessee was the sum of $19,412.54, which said sum was actually paid by said petitioner, as lessee, to said guardian, and said guardian did actually account to the said Superior Court of Kern County in the said guardianship proceedings for the receipt thereof [R. 7-8, 28, 32].

Each of the petitioners duly filed a gift tax return for the said year 1944, reporting therein the said gift of one-half the value of said property. Said property had a fair market value of $32,000.00 at the date of said gifts [R. 6, 27, 33].

Said guardian paid the sum of $24,000.00, together with interest thereon, from the assets of Shirley May's guardianship estate in accordance with the terms of said Exhibit F as the unpaid balance of the purchase price of said property [R. 32-33].

In the preparation of their respective income tax returns and the determination of their respective income tax liability for said taxable year 1944, each petitioner claimed one-half of said sum of $19,412.54, or the sum of $9,706.27, as a deduction from business income. The Commissioner of Internal Revenue disallowed said deduction and redetermined petitioners' respective income tax liability for said year. By reason of said redetermination of said tax liability, each petitioner paid an additional income tax for said year in the sum of $9,551.49 and interest thereon in the sum of $2,040.35 [R. 8, 9, 28, 30].

Thereafter, and within the time prescribed by law, each petitioner duly made and filed a written claim for refund

of income tax in the amount of $9,168.61, alleging as a basis of said claim the same grounds as stated in their respective complaints, to wit, the disallowance of said deduction for rental paid [R. 9, 10, 28, 30]. A true copy of said claim is attached to said complaint as Exhibit C [R. 11-16]. More than six months had elapsed since the date of filing said claims and the bringing of the within actions [R. 10, 28, 30].

All of the above-mentioned exhibits were introduced into evidence [R. 34].

In addition to the stipulated facts, uncontradicted testimony of witnesses called on behalf of petitioners, established the following facts:

The transfer of the property by petitioners to their daughter was a gift and so intended [R. 96]; that petitioners, or either of them, received no part of the rental in the sum of $19,412.54, nor was any portion thereof ever used to purchase anything for them or for either of them, nor did they, or either of them, ever exercise any control over any portion of it, nor did they, or either of them, ever have any of it in their possession after payment thereof to said guardian as rental [R. 97, 137, 138].

The lease between Margaret P. Osborne and Henry Kirschenmann was a development lease, which required the expenditure of large sums to develop the land into usable farming land [R. 97, 146, 147].

There was no determination prior to or at the time of the transfer of said property by petitioners as to the use to which it would be put, that is, whether it would be farmed by the guardian, leased to a third person, or leased to petitioner donor Henry Kirschenmann [R. 126-128].

The rental provided in the lease to be paid was in accordance with share crop leases generally used in the same area as here involved, and was consistent with the rental charged by Kern County Land Company in share-crop leases [R. 98, 99, 115, 116, 144-146, 149, 152, 156].

The sole purpose of the transfer of said property by petitioners to their daughter was to provide her with an estate of her own so that she would be assured of an education in the event petitioners should suffer reverses from their farming operations. The tax consequences of the transfer were not discussed except that petitioner, Henry Kirschenmann, was advised by his attorney that the income to be derived from the property would be taxable to petitioners' daughter [R. 99, 135, 136].

Reasons for Granting the Writ.

The decision below should be reviewed because it is in direct conflict with the decisions of the Courts of Appeal in the Third and Seventh Circuits, viz., *Brown v. Commissioner*, 180 F. 2d 926 (C. C. A. 3, 1950), cert. den., Oct. 9, 1950, 340 U. S. 814, 71 S. Ct. 42, and *Skemp v. Commissioner*, 168 F. 2d 598 (C. C. A. 7, 1948).

(1) In *Skemp v. Commissioner, supra*, taxpayer owned a building, in a part of which he maintained his medical clinic and the rest of which was arranged for rental to others for general office purposes. He created a trust for a term of twenty years for the benefit of his wife and chiddren and conveyed the building to a trust company as sole trustee. Taxpayer reserved the right to rent all or a part of the building at a rental to be determined by the trustee.

On the same day as the creation of the trust, the trustee and taxpayer entered into a lease of the entire building for a term of ten years. Taxpayer paid the rent according to the lease. Taxpayer deducted the rental paid in his income tax return. The Commissioner disallowed the deduction, and the Tax Court sustained the Commissioner (8 T. C. 415). In reversing the Tax Court, the United States Court of Appeals as did the Tax Court (8 T. C. 420), said at page 599:

> "The issue before us is the narrow one of deduction and does not involve the taxability of the trust income under *Helvering v. Clifford,* 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788."

The Court then quotes Section 23(a)(1)(A) of the Internal Revenue Code relating to the deduction of rental payments.

The Court then says at page 599:

> "Payments of rent are thus specifically included in the statute as deductions. Unless we are to impute to the trustee a violation of its fiduciary duty, the taxpayer is 'required' to pay these monthly sums —they are a legal and collectible obligation. Without further imputing such violation to the trustee, we cannot say that the taxpayer must not pay them 'as a condition to the continued use or possession.'"

And on page 600, the Court continues:

> "In this case we have a valid, irrevocable trust, wholly divesting the taxpayer of any interest in the trust property, and an agreement by the taxpayer to pay the trustee a reasonable rental under a valid lease. The income from the property is not claimed in this proceeding to be that of the taxpayer. We have here only a question of deduction of rental from gross in-

come. There can be no question but what rent required to be paid is properly deductible. The trustee was duty bound to exact rent of the taxpayer and the taxpayer was legally bound to pay it, just as much as if the taxpayer had moved across the street into the property of a third party. No one doubts that he would have had to pay rent then, and would have been entitled to deduct it even though he had voluntarily created that situation. We are not impressed with the argument of the Government that the taxpayer voluntarily created the present situation.

"Nor can we agree with the Commissioner's contention that there was no change in the taxpayer's economic status. He had irrevocably divested himself of all title and rights to the property and could occupy it only upon payment of rent, the amount of which was to be fixed by the trustee."

(2) In *Brown v. Commissioner, supra,* a case in which the facts are strikingly analogous to the facts in the instant case, the taxpayers, husband and wife, were partners engaged in the general contracting and coal mining business. In 1943 they purchased two tracts of land, on one of which was located a railroad siding for loading coal, which they had used on a per car fee basis. The other tract was coal land which taxpayers intended to mine. Shortly after the purchase of the two tracts of land, taxpayers discussed with their attorneys the matter of the future financial security of their two sons, one aged about two years, and the other about six months. A trust was suggested whereby the two tracts would be transferred to one of their attorneys as trustee, "with the understanding that the properties were to be leased to the taxpayers, who were, as always intended, to continue to operate them under their partnership agreement." Accordingly, the trusts were

executed and on the following day the trustee leased the two properties to the taxpayers. In 1944, taxpayers paid an aggregate of $20,482.28 as rental and royalties for the use of the two properties. Taxpayers claimed said rentals and royalties as a deduction on their partnership return for said year 1944. The Commissioner disallowed the deduction. The Tax Court sustained the Commissioner (12 T. C. 1095).

In reversing the Tax Court, the United States Court of Appeals said at page 929:

> "By the trust agreements the taxpayers conveyed to an independent trustee title to the land upon which the siding was located and the coal land. The trustee then leased them back to the taxpayers upon what were found by the Tax Court to be reasonable rents and royalties. It is true that this was done pursuant to a prior understanding between the taxpayers and the prospective trustee but we do not regard this point as significant. What is controlling is that there came into the picture a new independent owner, the trustee, who was in a position to and did require the payment of the rents and royalties as a condition to the continued use and possession of the lands by the taxpayers for the purposes of their business and wholly without regard to whether their operations resulted in taxable income.
>
> "The taxpayers were legally obligated to pay the rents and royalties for the use of the siding and the mining of the coal even though their operations had resulted in a loss. The deduction of these rents and royalties was authorized by the express language of Section 23(a)(1)(A) of the Internal Revenue Code."

The Court then quotes with approval from *Skemp v. Commissioner, supra,* pages 599, 600.

(3) Paraphrasing the *Skemp* and *Brown* cases, *supra;* hereto a new, independent owner, namely, Shirley May Kirschenmann, came into the picture. Since she was a minor, a guardian was appointed to act for her under the direction and control of a court of competent jurisdiction. She thus became a ward of the court. *Fox v. Minor,* 32 Cal. 111 (1867). Certainly, we are not to impute to the Court a violation of its duty—it is stipulated that the guardian executed the lease under order of the Court [R. 7, par. VIII; 27, par. VIII; 30, par. V]. The trial court found as a fact that the lease and the share-crop rental therein provided were in conformity with share-crop leases then in general use in Kern County, the county in which the property was located [R. 76]. Hence, the rental was reasonable.

Here, too, the rental was payable even though petitioners' farming operations had resulted in a loss.

Here also the guardian, under the supervision and authority of the Court, was in a position and duty bound under the law to, and did, require the payment of the rents "as a condition to the continued use and possession of the lands by the taxpayers for the purposes of their business, and wholly without regard to whether their operations resulted in taxable income."

The gift made by petitioners to their daughter was wholly and completely unconditional and unfettered. The guardian or the Court, acting, independently, could have refused to lease the property to petitioners, could have caused it to be otherwise farmed or used or could have sold it and reinvested the proceeds [R. 126-128].

Resch v. Commissioner, 20 T. C. 21.

(4) The Court below states that the *Brown* and *Skemp* cases, *supra,* do not support petitioner's position because in the cited cases the rent paid was held not to be unreasonable, while in the instant cases, no such finding was made [R. 170]. This statement ignores Finding of Fact XV [R. 76] that "The lease and the share crop rental therein provided for was in conformity with share crop leases then in general use in Kern County," the county in which the subject property was located. It would seem to follow that if the rent paid is in conformity with rent paid generally in the same locale, such rent must of necessity be reasonable, else all rental in such locale would be unreasonable. Hence, there was a finding made that the rent paid was reasonable. Regulation 118, Section 39.23(a)(6), states "It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances." In other words, compensation is reasonable if it is in conformity with compensation paid generally for like services. It would follow, it is submitted, that the same rule is applicable to rent—if rent paid is in conformity with rent paid generally in the same locale, it must be reasonable.

(5) The Court below [R. 170] compared the 1940 Osborne lease with the 1944 Shirley May lease, without noting the difference between the leases. The Osborne lease was a development lease—one of raw land which must be developed by the lessee at substantial costs before the property can be farmed. The Shirley May lease was an agricultural lease, one of improved and developed land ready to farm. The rental of a development lease is less than of an agricultural lease. Rental values were higher

in 1944 than in 1940 due in part to the higher value of potatoes in 1944 than in 1940. The amount paid as rent under the Shirley May lease in 1944 was the result of a good crop and a high market value for potatoes [Ex. H, R. 47-51, 97, 98, 106, 110, 115, 117, 139-142, 146-147].

(6) The statement [R. 170] of the Court below that the disparity in the two rentals was the result of a studied attempt to gain a tax advantage is contrary to and beyond the record and substitutes the Court's conclusion for the clear and uncontradicted testimony to the contrary [R. 99, 101, 135-136]. It is error for a court not to follow uncontradicted testimony.

> *Grace Bros. Inc. v. Commissioner*, 173 F. 2d 170, 174 (C. C. A. 9, 1949).

(7) Tax motives, however relevant they may be in determining whether the transaction was real or a sham, cannot change the transaction if it is carried out bona fide. *United States v. Cumberland Public Service Co.*, 338 U. S. 451, 70 S. Ct. 280 (1950), and the Court below recognized that petitioners divested themselves of title to the property [R. 170], yet refused to give any recognition to the lease by which they *regained* possession under the requirement of paying the rental called for in the lease.

(8) The Court's statement [R. 171] that "what is found here lacks business meaning for tax purposes" appears meaningless—because "what is found here" is a valid gift which requires no business meaning or purpose.

(9) The concurring opinion is contrary to the real property law of the State of California. The grant deeds from petitioners to their daughter [R. 44-47] tranferred *all* of their right, title and interest in and to the property and were expressly made subject to the balance of the purchase price.

A grant deed is a conveyance (Civ. Code, Sec. 1092); the transfer of a thing transfers all its incidents (Civ. Code, Sec. 1084); where a person purports by proper instrument to grant real property in fee simple, and subsequently acquires any title or claim of title thereto, the same passes by operation of law to the grantee, or his successors (Civ. Code, Sec. 1106); and in California no deficiency judgment lies for the unpaid balance of the purchase price under a contract of sale (Civ. Code, Sec. 580b). The real property law of California controls with respect to what title passed.

Blair v. Commissioner, 300 U. S. 5, 57 S. Ct. 330.

Petitioners, under California law, thus passed every incident of title which they held and the after acquired fee passed automatically to Shirley May by operation of law.

(10) From the foregoing it appears that the instant case is on "all fours" with the *Brown* and *Skemp* cases, *supra,* and the decision of the Court below is in direct conflict with the decisions in the cited cases.

Conclusion.

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

LLEWELLYN A. LUCE,
LLOYD G. RAINEY,
J. EVERETT BLUM,
Counsel for Petitioners.

APPENDIX.

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Adeline Kirschenmann, appellant, vs. Harry C. Westover, United States Collector of Internal Revenue for the Sixth District of California, Appellee.

Henry Kirschenmann, appellant, vs. Harry C. Westover, United States Collector of Internal Revenue for the Sixth District of California, appellee. No. 13,736.

March 8, 1955.

Appeals from the United States District Court for the Southern District of California, Central Division.

Before STEPHENS and FEE, Circuit Judges, and LING, District Judge.

LING, District Judge:

Taxpayers are husband and wife. In 1944, the taxable year here in question, and prior thereto, the husband was engaged in farming operations in Kern County, California. Part of the land used in this operation was a quarter section leased from one Margaret P. Osborne, under lease dated September 19, 1940. The lease was for five years, commencing November 1, 1941, at a total rental of $4550. Of this amount $700 was payable each year for the first two years and $1050 each remaining year. During the life of the lease, on August 25, 1943, taxpayers agreed with the lessor-owner to purchase the

property for a down payment of $8000 and a like amount each year for three years thereafter.

On January 9, 1944, without valuable consideration, taxpayers conveyed their interest in the property to their minor daughter. Prior to this transaction they had discussed with their attorney the incident tax consequences. On February 7, 1944, Edward Kirschenmann, a brother of taxpayer, Henry Kirschenmann, was legally appointed guardian of the daughter's estate. Two weeks later the guardian leased the property back to taxpayers for a five year term, commencing July, 1944. The lease was a share-crop agreement, under the terms of which in the Fall of 1944 taxpayers paid the guardian $19,412.54 as rental for that year.[1] This represented a substantial part of the amount realized from farming the land. The child

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[1]Following are excerpts from the testimony of Henry Kirshenmann:

"Q. Then this lease which you made, which you entered into as lessee from your brother Edward in 1944, was the only lease you have entered into, or entered into in this period on a share-crop basis, is that correct? A. That is right.

* * * * *

"The Court: Did you have any other similar lease on property where you were raising potatoes—

"The Witness: No.

"Q. (By Mr. McHale): Have you ever had any since?

"The Court: That is all the rest of them were cash leases?

"The Witness: Yes, sir.

"The Court: Go ahead.

"Q. (By Mr. McHale): Have you ever had any since similar to this? A. No.

* * * * *

"Q. Could you give us an estimate of the number of acres you were farming in and about that period (1942-3-4), Mr. Kirschenmann? A. Oh, I was farming between 700 and a thousand acres of potatoes through the year."

took no part in the farming operation and her parents exercised the same control over the property as before; community assets, credit and effort being used in the farming operation. The balance of $24,000 due under the purchase agreement was paid by the guardian with funds from his ward's estate.

Parenthetically it may be added, that in December 1943, Edward Kirschenmann conveyed a quarter section of land to his children and his brother Henry was appointed guardian of their estates. As here, a share-crop lease was given the parents. All parties to both transactions were represented by the same attorney.

Taxpayers deducted from their 1944 gross community income the amount of $19,412.54 as rental paid. The question for determination is whether this amount was paid as a condition to the continued use of the property for the purposes of their business.[2] The District Court held against taxpayers.

It is contended that Skemp v. Commissioner, 168 F. 2d 598, and Brown v. Commissioner, 180 F. 2d 926, support

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[2]SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

(a) (as amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798) Expenses.—

(1) Trade or Business Expenses.—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a condtiion to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

* * * * * * * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

taxpayers' position. We cannot agree. In both of these cases it was held that the rent paid was not unreasonable. Here no like finding was made, nor could such conclusion find support on the record. Taxpayers by the terms of their lease with Mrs. Osborne were obligated to pay only $1050 for the year in question; instead, by their own contrivance, they elected to pay $19,412.54. To say in this situation that such disparity was not the result of a studied attempt to gain a tax advantage would indicate a blindness to reality. It is true, taxpayers divested themselves of title to the property, yet they farmed the land as before, and in effect it was their earning power which formed the basis for the entire transaction, including payment of the purchase price. Tax consequences are determined not from the formal aspect of a transaction, but from the actual substance of a piece of business. What is found here lacks business meaning for tax purposes. This court's decision in Shaffer Terminals, Inc. v. Commissioner, 194 F. 2d 539, is controlling.

The instant case involved another issue which was resolved against taxpayers in the District Court. Originally, the Court's ruling on this disputed point was challenged here. However, it now appears that, while this appeal was pending, the parties stipulated that the judgment of the District Court on the question was correct. We have not therefore considered the matter.

Affirmed.

JAMES ALGER FEE, concurring:

The majority opinion is correct and sound. However, clarification may assist.

The statute provides that there should be allowed as deductions "rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity." Section 23(a)(1)(A), Internal Revenue Code. Unless taxpayers here had made a transfer of their entire equity, no deduction would be allowable under this section. The deed to their daughter did not convey the fee because they did not own the fee. After the transfer of some interest to their daughter, taxpayers, not their daughter or her guardian, were bound to pay the balance of the purchase price and were still the owners of an equity in the parcel until this was paid. If there had been a default, they would have been the defendants, since they were in possession and were the vendees. After the purchase price had been paid in full, title to the parcel was taken in taxpayers' names.

Taxpayers are not entitled to the deduction claimed here, since they have failed to show that the payments were made for the use of "property to which the taxpayer has not taken or is not taking title or in which he has no equity." Besides, the payments of the so-called "rental" were not and could not have been made to the daughter or her guardian under the circumstances "as a condition to the continued use or possession" of the property.

(Endorsed): Opinion and Concurring Opinion. Filed Mar. 8, 1955. Paul P. O'Brien, Clerk.

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 194

ADELINE KIRSCHENMANN, PETITIONER

v.

HARRY C. WESTOVER, United States Collector of Internal Revenue for the Sixth District of California

---

HENRY KIRSCHENMANN, PETITIONER

v.

HARRY C. WESTOVER, United States Collector of Internal Revenue for the Sixth District of California

---

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the District Court (R. 70-72) and its findings of fact and conclusions of law (R. 73-81) are not yet reported. The opin-

ions of the Court of Appeals (R. 168-172; Pet. App. 1-5) are not yet reported.

JURISDICTION

The judgment of the Court of Appeals was entered March 8, 1955 (R. 173). A petition for rehearing filed by the taxpayers was denied May 31, 1955 (R. 174). The petition for a writ of certiorari was filed June 30, 1955. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Taxpayers (husband and wife), lessees of land used in their business, contracted prior to expiration of the lease to purchase the land from the lessor, donated their interest in the purchase contract to their twelve year old daughter, and leased back the land from the daughter's guardian (taxpayer-husband's brother) at a rental many times in excess of that which they were obligated to pay under the pre-existing lease. The arrangement produced no change in taxpayers' use and control of the land, its purpose being tax avoidance.

The question is whether the court below erred in affirming the District Court's conclusion that the amount paid by taxpayers to their daughter's estate as "rent" was not deductible from their taxable incomes under Section 23(a)(1)(A) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * trades, businesses, * * * or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

[26 U.S.C. 1952 ed., Sec. 22.]

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

[26 U.S.C. 1952 ed., Sec. 23.]

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.23(a)-1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *. * * * Among the items included in business expenses are * * * rental for the use of business property. * * *

STATEMENT

Taxpayers are a husband and wife, who in 1944 filed their income tax returns on a community property basis. They each brought suit in the United States District Court for the Southern District of California seeking refund of income taxes paid following deficiency assessments for the year 1944. They claimed that the Commissioner of Internal Revenue had erroneously disallowed as a business expense deduction amounts paid in that year as "rent" to their minor daughter's guardian for the use of land which taxpayers in the same year had given to their daughter and had then leased back from her estate.[1] The District Court sustained the Commissioner (R. 70-72) and entered judgment for the Collector (R. 82-85). The Court of Appeals unanimously affirmed (R. 168-

[1] Originally taxpayers also sought an additional refund on an unrelated issue, which is not before this Court. This other issue was decided in the District Court in favor of the Collector (R. 70-71), and was disposed of in the court below by stipulation (R. 161-162, 171; Pet. App. 4).

171; Pet. App. 1-5), with one judge filing a brief concurring opinion (R. 171-172; Pet. App. 5).

The facts found by the District Court (R. 73-80) may be summarized as follows:[2]

In 1944 and prior thereto taxpayer-husband carried on a potato farming business in California. Part of the land used for that purpose was leased from one Margaret P. Osborne, under a five-year lease which was to expire October 31, 1946. The total rental under this lease was $4,550, of which $700 was payable for each of the first two years, and $1,050 for each remaining year. (R. 75.)

In August, 1943, about three years before the expiration of the lease, taxpayers agreed to purchase the land from Mrs. Osborne for a down payment of $8,000 and a like amount payable in each of the following three years. In January, 1944, taxpayers made a gift of their interest in the land to their daughter, age twelve, and the following month taxpayer-husband's brother was appointed guardian of the daughter's estate by the California Superior Court. Two weeks later the guardian leased the property back to taxpayer-husband for a five-year term, commencing July 1, 1944, on a share-crop basis. The lease and rental were in conformity with share-crop leases then in general use in the locality. In the fall of 1944, taxpayers paid to their daughter's estate $19,412.54 as

[2] The evidence consists principally of stipulations of fact (R. 30-35) and exhibits (R. 35-70). Taxpayers also offered oral testimony (R. 94-156).

"rental" for that year. (R. 75-77.) A similar gift-guardianship-leaseback arrangement was made with respect to land owned by the guardian-brother for the benefit of his minor children, taxpayer-husband being appointed their guardian (R. 77).

The balance of the price ($24,000) due under the purchase agreement between taxpayers and Mrs. Osborne was paid out of the daughter's estate over the following two-year period. Upon completion of the payments quit claim deeds were delivered by Mrs. Osborne's heirs (she had since died) to taxpayers. (R. 77-78.)

After the gift to their daughter and appointment of taxpayer-husband's brother as her guardian, taxpayers continued to exercise the same exclusive control over the land as before (R. 78). The rental arrangement between taxpayers and their daughter's estate was expressly found to have been "not entered into * * * in good faith and for a business purpose, but as a tax avoidance device" (R. 79).

Taxpayers deducted from their community business income for the year 1944 the $19,412.54 paid to their daughter's estate as "rental" for that year. When the Commissioner disallowed the deduction, taxpayers paid the resulting deficiencies, and brought suits for refund, which were consolidated for trial and for appeal.

Deciding that taxpayers "in reality retained control of the property", the District Court held that the "arrangement was not necessary or made

for the purpose of carrying on" taxpayers' potato farming business, and that taxpayers had in fact "retained an interest or equity" in the property which they had purportedly rented from their daughter's estate (R. 71, 80). The court also concluded "that the amount deducted was greater than could be considered as ordinary and necessary expense in conducting" taxpayers' farming business (R. 72).

In affirming, the Court of Appeals specifically noted that not only was there no finding that the so-called rent paid was reasonable, but that such a finding could not have found support in the record (R. 170; Pet. App. 4). That court also stated (R. 170-171, Pet. App. 4):

> Taxpayers by the terms of their lease with Mrs. Osborne were obligated to pay only $1050 for the year in question; instead, by their own contrivance, they elected to pay $19,412.54. To say in this situation that such disparity was not the result of a studied attempt to gain a tax advantage would indicate a blindness to reality. It is true, taxpayers divested themselves of title to the propery, yet they farmed the land as before, and in effect it was their earning power which formed the basis for the entire transaction, including payment of the purchase price. Tax consequences are determined not from the formal aspect of a transaction, but from the actual substance of a piece of business. What is found here lacks business meaning for tax purposes.

ARGUMENT

Contrary to taxpayers' argument (Pet. 8-15), the decision below is correct and involves no conflict of decisions or questions requiring settlement by this Court.

The case poses the now familiar question of whether an intra-family gift and leaseback arrangement, resulting in a reallocation of the donor's income within the family group, is to be accorded federal income tax effect. The same question was presented in *White* v. *Fitzpatrick,* 193 F. 2d 398 (C.A. 2d), certiorari denied, 343 U.S. 928, involving a similar arrangement, and the decision below is fully in accord with the decision in that case. Nothing has occurred since the denial of certiorari in the *White* case which would appear to warrant the granting of certiorari in this case, and there is no more occasion for further review of this case than of that one. Indeed, taxpayers here take essentially the same position, and rely for conflict upon the same decisions, *Skemp* v. *Commissioner,* 168 F. 2d 598 (C.A. 7th), and *Brown* v. *Commissioner,* 180 F. 2d 926 (C.A. 3d), certiorari denied, 340 U.S. 814, as did the taxpayer in the *White* case.

1. Section 22(a) of the Internal Revenue Code of 1939, *supra,* p. 3, broadly defines gross income as including income derived from a business, or from any other source whatever. Section 23(a)(1)(A), *supra,* p. 3, authorizes a deduction from gross income of "ordinary and neces-

sary" business expenses, including rental payments required to be made as a condition to the continued use or possession of business property. That an expense is contractually incurred does not render the payment of it deductible; the "origin and nature" of the liability out of which the expense accrues, not its legal form, determines the right to the deduction. *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 594; *Deputy* v. *duPont*, 308 U.S. 488, 494-496. [3] This rule is rooted in the fundamental principle that taxation is an intensely practical process, concerned with economic realities rather than legal formalities. [4] Where as here we are dealing with an intra-family transfer, the transaction is subject to special scrutiny lest what is in reality the income of one member of the family be disguised as that of another. [5] These prin-

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[3] In the *Interstate Transit Lines* case this Court stated (p. 594) that—

> The mere fact that the expense was incurred under contractual obligation does not of course make it the equivalent of a rightful deduction under § 23(a). * * * The origin and nature, and not the legal form, of the expense sought to be deducted determines the applicability of the words of §23(a).

[4] *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *Higgins* v. *Smith*, 308 U.S. 473; *Griffiths* v. *Commissioner*, 308 U.S. 355; *Gregory* v. *Helvering*, 293 U.S. 465.

[5] *Helvering* v. *Clifford*, 309 U.S. 331; *Helvering* v. *Stuart*, 317 U.S. 154; *Harrison* v. *Schaffner*, 312 U.S. 579; *Douglas* v. *Willcuts*, 296 U.S. 1; *Corliss* v. *Bowers*, 281 U.S. 376; *Burnet* v. *Wells*, 289 U.S. 670; *Commissioner* v. *Sunnen*, 333 U.S. 591; *Commissioner* v. *Tower*, 327 U.S. 280; *Commissioner* v. *Culbertson*, 337 U.S. 733.

ciples have been applied by the Courts of Appeals in a variety of contexts, including cases involving claimed business expense deductions.[6]

2. In this case, taxpayers seek to deduct from their community business income, and to treat as the income of their minor daughter, an amount paid to the daughter's estate as "rental" for property used in their business. They claim the deduction by virtue of a gift of the property to the daughter, appointment of taxpayer-husband's brother as guardian of the daughter, and a substantially contemporaneous leaseback of the property. The claim must fail for two reasons: (a) the arrangement amounted in substance to an assignment to the daughter of a portion of taxpayers' business income; and (b) the so-called rental payments do not in any event qualify for deduction under Section 23(a)(1)(A).

(a). In harmony with the rule that tax consequences flow from the substance rather than the form of a transaction, it is well settled that a transfer of legal title to income-producing pro-

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[6] See *White* v. *Fitzpatrick*, *supra*, p. 8, and cases there cited. Similarly, business expense deductions have been denied for payments which were labeled as rent or as other expenses or deductible items but were in reality dividend distributions. See *Stanwick's, Inc.* v. *Commissioner*, 190 F. 2d 84 (C.A. 4th); *W. H. Armston Co.* v. *Commissioner*, 188 F. 2d 531 (C.A. 5th); *Ingle Coal Corp.* v. *Commissioner*, 174 F. 2d 569 (C.A. 7th); *Limericks, Inc.* v. *Commissioner*, 165 F. 2d 483 (C.A. 5th); *Paramount-Richards Th.* v. *Commissioner*, 153 F. 2d 602, 604 (C.A. 5th); *Regensburg* v. *Commissioner*, 144 F. 2d 41 (C.A. 2d), certiorari denied, 323 U.S. 783; *Illinois Agricultural Hold. Co.* v. *Commissioner*, 131 F. 2d 583 (C.A. 7th).

perty does not suffice to insulate the transferor from tax liability, even though the income is paid over to the transferee, if the transferor remains the substantial owner of the property. Such a transfer is in substance and effect merely an assignment of the income. *Commissioner* v. *Sunnen,* 333 U.S. 591; *Helvering* v. *Clifford,* 309 U.S. 331; *Harrison* v. *Schaffner,* 312 U.S. 579; *Commissioner* v. *Tower,* 327 U.S. 280; *Commissioner* v. *Culbertson,* 337 U.S. 733. It is equally settled that retention of control over the property is tantamount to retention of substantial ownership, and it is an important factor, in determining whether the transferor has retained sufficient control to warrant treating him as the real owner for tax purposes, that the parties are closely related. *Helvering* v. *Clifford, supra; Commissioner* v. *Sunnen, supra,* p. 605. Accordingly, if the instant gift-leaseback arrangement did not divest taxpayers of actual command over the donated property, the arrangement amounted to nothing more than an assignment of income to the daughter in the guise of rental payments, and the payments are not deductible from taxpayers' incomes.

As is plain from its opinion, the court below properly applied these principles to the facts of this case. The District Court found (R. 71-72, 79) that taxpayers continued to enjoy the same control over the property after the gift and leaseback as before; that the arrangement was not entered into in good faith and for a business purpose, but to avoid tax; and that the "rental" paid

to the daughter's estate constituted a part of the income earned by taxpayers in their farming business.[7] On the basis of these facts the court below correctly affirmed the District Court's disallowance of the claimed rent deduction. When the transaction is viewed from beginning to end, as it must be, the conclusion is inescapable that its only practical effect was to shift to the daughter a portion of taxpayers' income, while leaving intact their effective control over the donated property. The court below aptly observed that while "taxpayers divested themselves of title to the property, yet they farmed the land as before, and in effect it was their earning power which formed the basis for the entire transaction" (R. 170; Pet. App. 4). Cf. *White* v. *Fitzpatrick*, 193 F. 2d 398 (C.A. 2d), certiorari denied, 343 U.S. 928; *W. H. Armston Co.* v. *Commissioner*, 188 F. 2d 531 (C.A. 5th); *Shaffer Terminals, Inc.* v. *Commissioner*, 16 T.C. 356, affirmed, 194 F. 2d 539 (C.A. 9th); *Ingle Coal Corp.* v. *Commissioner*, 174 F. 2d 569 (C.A. 7th).

(b). In any event, even assuming (contrary to

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[7] Taxpayers' contention (Pet. 12) that the gift was "unconditional and unfettered" rests upon general self-serving assertions by their attorney (R. 126-128). Significantly, taxpayer-husband's brother was appointed guardian of the donee-daughter, and the brother made a reciprocal arrangement for the benefit of his own minor children with taxpayer-husband as guardian (R. 77)—a feature which lends support to the finding that taxpayers did not relinquish dominion over the property and that "the purported gifts and reciprocal guardianships were employed to conceal the retention of [taxpayers'] control of the land in question" (R. 79).

the District Court's findings) that taxpayers parted with substantial ownership of the property, the so-called rental payments to the donee-daughter under the leaseback agreement still would not qualify for deduction under Section 23(a)(1)(A). The provisions of that section must of course be examined in the light of the "now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer". *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590, 593. See also *New Colonial Co.* v. *Helvering,* 292 U.S. 435, 440; *Deputy* v. *du Pont,* 308 U.S. 488, 493; *Commissioner* v. *Jacobson,* 336 U.S. 28, 48-49; *McDonald* v. *Commissioner,* 323 U.S. 57, 60.

To qualify for deduction under Section 23(a) the rental payment in question must have been an "ordinary and necessary" expense of carrying on taxpayers' farming business during the taxable year, and taxpayers must have been "required" to make them "as a condition to the continued use or possession" of the property. These statutory conditions clearly have not been met in this case. Taxpayers could have continued to use the land throughout the taxable year (1944) at a rental which was but a fraction of the amount paid to the daughter as rental, simply by continuing as lessees under the then existing Osborne lease. The District Court found (R. 75-79), and it is undisputed, that taxpayers were in possession of the property under a five-year lease from Mrs.

Osborne which would not terminate until the fall of 1946; that the rental for 1944 was $1,050; that in August of 1943 taxpayer contracted to purchase the property from Mrs. Osborne for a down payment of $8,000 and a like amount payable in each of the three subsequent years; that at the beginning of 1944 taxpayers gratuitously conveyed their interest in the purchase contract to their daughter; that two weeks later the daughter's guardian (taxpayer-husband's brother) leased the property back under a share-crop agreement pursuant to which taxpayers paid $19,412 to the daughter's estate as rental for 1944;[8] and that the balance of the price due under the purchase contract was paid by the daughter's estate out of the so-called rental payments received from taxpayers.

In the light of these facts the District Court was unquestionably justified in concluding that the expense was not an "ordinary and necessary" one (R. 71-72, 78-79), and the court below correctly affirmed its decision on that ground. The expense was neither "ordinary" nor "necessary",

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[8] Taxpayers seek comfort (Pet. 13) in the District Court's finding (R. 76) that the rental provided in the new lease was in conformity with share-crop leases in general use in the same locale. However, taxpayers ignore the critical fact, also found by the District Court (R. 71-72, 78-79), and properly stressed by the court below (R. 170; Pet. App. 4), that taxpayers were required to pay a rental of only $1,050 under the Osborne lease in order to continue in possession during 1944, yet undertook by the gift-leaseback arrangement to pay $19,412 to their daughter instead. As the court below noted, there is no finding here that the latter amount was reasonable, "nor could such conclusion find support on the record". (R. 170; Pet. App. 4).

since taxpayers already had the right to use the property throughout the taxable year without paying any more for its use than the amount they had contracted to pay to the original lessor. Looking through form to substance, the only result of the transaction was to increase almost twenty-fold the rental which taxpayers were obliged to pay, but to make the increased amount payable to a member of the family instead of to a stranger. In the words of the court below (R. 170; Pet. App. 4), "Taxpayers by the terms of their lease with Mrs. Osborne were obligated to pay only $1,050 for the year in question; instead, by their own contrivance, they elected to pay $19,412.54." Moreover, as pointed out in the concurring opinion below (R. 171; Pet. App. 5), taxpayers failed to meet the additional requirement of Section 23(a)(1)(A) that the rental be paid for "property to which the taxpayer has not taken or is not taking title or in which he has no equity".

3. The decision below is not in conflict with any decision of this Court or of any of the Courts of Appeals. Taxpayers assert conflict with *Skemp* v. *Commissioner*, 168 F. 2d 598 (C.A. 7th), and *Brown* v. *Commissioner*, 180 F. 2d 926 (C.A. 3d), certiorari denied, 340 U.S. 814. Although those cases appear to have been incorrectly decided and have been properly criticized,[9] in any event they

[9] In distinguishing the *Skemp* and *Brown* cases, the Second Circuit stated in *White* v. *Fitzpatrick*, 193 F. 2d at 401:

> These cases, which are criticized in reasoned discussions in 51 Col. L. Rev. 247 and 59 Yale L. J. 1529, may be thought to go to the verge of the law in support of what are essentially intrafamily transfers.

are clearly distinguishable on their facts for the reasons specifically pointed out by the court below (R. 170; Pet. App. 3-4).

In both the *Skemp* and *Brown* cases the gifts were made to independent trustees, the donor-taxpayer retained no control over the property, and the rent charged by the trustee was reasonable. No such situation is here presented. Here the arrangement was made with taxpayer-husband's brother as guardian of the donee-daughter; taxpayers in fact retained control over the property; and the rent charged was far in excess of the amount they were required to pay under the preexisting lease which still had several years to run. When a comparison is made between this case and others, it becomes evident that its factual resemblance is distinctly closer to the *White* case than to either *Skemp* or *Brown,* for the same reasons that these latter two cases were specifically distinguished in *White* (see 193 F. 2d at 401). Indeed, the very court which decided the *Skemp* case later distinguished it in *Ingle Coal Corp* v. *Commissioner,* 174 F. 2d 569, 572, on the grounds that in *Skemp* the taxpayer transferred the property "to an independent trustee-bank, retaining no control", and that consequently "there was a change in the taxpayer's economic status".

In this case both courts below concluded that the gift and leaseback produced no substantial change in taxpayers' control and economic status. Their concurrent findings should not be disturbed. "A seasoned and wise rule of this Court makes con-

current findings of two courts below final here in the absence of very exceptional showing of error." *Comstock* v. *Group of Investors,* 335 U.S. 211, 214.

CONCLUSION

The decision below is correct. There is no conflict, and no occasion for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted.

SIMON E. SOBELOFF,
Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
HARRY BAUM,
Attorneys.

JULY, 1955.

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IN THE

Supreme Court of the United States

October Term, 1955

No. 194

ADELINE KIRSCHENMANN,

Petitioner,

vs.

HARRY C. WESTOVER, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA,

Respondent.

HENRY KIRSCHENMANN,

Petitioner,

vs.

HARRY C. WESTOVER, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR THE PETITIONERS IN REPLY.

Argument.

1. Respondent's argument, as the decisions of the Courts below, is based on three major fallacies, namely (a) that petitioners *retained* control of the subject property; (b) that the amount of the rent paid in 1944 to petitioners' daughter was specified in the lease in terms

of dollars to be $19,412.54, and (c) that the rent paid in 1944 in the sum of $19,412.54 was not ordinary and necessary solely because petitioners could have refrained from purchasing the property and thus continued to operated under the Osborne lease.

(a) Respondent states that the transaction, *i. e.*, the gift and the lease back, merely shifted a portion of the petitioners' income to the daughter "while *leaving* intact their effective control over the donated property." (Emphasis added.) This is an erroneous statement. From the moment of the gift until the execution of the lease, after the Court had approved its execution, petitioners were left with no control, effective or otherwise, over the subject property. Upon the execution of the lease, and not otherwise, petitioners *regained* possession and control of the property, subject to the burden of paying rent based on the *share-crop formula* specified in the lease.

The gift and the lease-back in the instant case left intact petitioners' effective control over the donated property to no greater or lesser extent than the taxpayers were left with such control in *Skemp v. Commissioner*, 168 F. 2d 598 (C. C. A. 7, 1948), and *Brown v. Commissioner*, 180 F. 2d 926 (C. C. A. 3, 1950), cert. den. Oct. 9, 1950, 340 U. S. 814, 71 S. Ct. 42. With respect to whether petitioners retained or regained control of the donated property, the instant case *cannot* be distinguished from *Skemp v. Commissioner, supra*, and *Brown v. Commissioner, supra*.

Respondent relies heavily on *White v. Fitzpatrick*, 193 F. 2d 398 (C. C. A. 2, 1951), cert. den. 343 U. S. 928. The *White* case is clearly distinguishable on the facts. Indeed the Court in the *White* case distinguished

it from the *Skemp* and the *Brown* cases and approved the decisions in said cases. The Court in the *White* case, at 401, in speaking of the *Skemp* and *Brown* cases, said:

> "In upholding the deductions, both courts expressly emphasized the independence of the trustees. It is probable that a like result would probably have obtained had the question been one of gross income under I. R. C., Sec. 22(a). For three factors determine attributability of income to the settlor of a family trust. Whether these are conjunctive tests, see Helvering v. Clifford, *supra,* 309 U. S. at page 335, 60 S. Ct. 554, or alternative, under the new Clifford regulations, U. S. Treas. Reg. No. 111, Sec. 29.22(a)-21; Kay v. C. I. R., 3 Cir., 178 F. 2d 772, it seems likely that in both the cases relied on, income would have been attributable to the trusts and thus to the beneficiaries, rather than the settlors. For (1) the settlors retained no reversionary interests; (2) they retained no dispositive power over either corpus or income; and (3) administrative control was not exercisable primarily for the benefit of the settlors."

In a footnote, page 401, the Court noted that in the *Skemp* case the taxpayer reserved the right to rent the donated property, and said

> "but this does not constitute 'beneficial enjoyment' of the property in the Clifford[1] sense."

In the *White* case, one of the gifts was of a patent "to the full end of the term of said patent." and the license back was "to the full end of the entire term of said

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[1]*Helvering v. Clifford,* 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788.

patent." Of this the Court, in further reference to the *Skemp* and *Brown* cases, in the footnote on page 401, said:

> "Moreover, both leases back were for a term and were not coextensive with the life of the trust."

And in a footnote on page 402, the Court said:

> "Here the factor of independent trusteeship is crucial, and it is in this respect that the instant case differs on its facts from the Skemp and Brown results."

The *White* case differs on its facts from the instant case in the same respects as it differs from the *Skemp* and *Brown* cases.

Here, as in *Skemp* and *Brown*, an independent new owner came into being—a guardian, acting under the authority, control and jurisdiction of an independent Court of California, here, as there, the lease was for a term and not coextensive with the full life of the property or of the guardianship.

(b) Respondent, as did the Courts below, erroneously interprets the lease as one for the payment of rent in the specified sum of $19,412.54 for the year 1944. The Court of Appeals said [R. 173; Pet. App. 4]:

> ". . . instead, by their own contrivance, they *elected* to pay $19,412.54." (Emphasis added.)

Petitioners did not "elect" to pay a single penny as rent. They merely agreed to pay certain fractions of the gross harvest of the crop based on the market price of the crop. Had there been a complete crop failure so that there would have been no harvest, could it be said that petitioners by their own contrivance, elected to pay no rent. The amount of the rent in the sum of $19,412.54

actually paid in 1944 was a result, not an election. It was the result of a good crop bringing a high market price. [R. 98, 139-143; Pet. 13-14.] The rent paid was based on a formula that was in conformity with share crop leases than in general use in Kern County [R. 76; Pet. 13], and hence was of necessity reasonable. [Pet. 13; R. 98-99.]

(c) Respondent argues, as the Courts below determined, that the rent paid by petitioners was not ordinary and necessary solely because petitioners could have refrained from using permissible business judgment, not purchased the subject property and hence continued to farm the property under the Osborne lease and pay the rent therein called for. (Resp. Br. 12-15.) Such argument ignores the fact that petitioners purchased the subject property in August, 1943, and hence the Osborne lease was merged into the superior title and vanished. It follows that Respondent's argument boils down to a statement that Petitioners were barred by law from exercising permissible business judgment and likewise barred from purchasing the property. Certainly such is not the law. A taxpayer may choose any form of doing business he desires even if his reason for choosing the particular form is to minimize taxes.

United States v. Cumberland Public Service Co., 338 U. S. 451.

The Osborne lease has no bearing in the instant case, for the reason that it was superseded by the purchase of the property in 1943, and was not in existence in 1944 and hence the Petitioners could not have farmed under it.

Further, the two leases were entirely different. The Osborne lease was a development lease, the Shirley May

lease was an agricultural lease. The former provided for a straight cash rental, the latter a contingent share crop or percentage rental. [Pet. 13.]

Exactly the same situation existed in *Brown v. Commissioner,* 180 F. 2d 926. There the taxpayers rented a railroad siding in their mining operations. They paid as rent $2.50 a car regardless of the amount of coal loaded. The siding was capable of holding 30 coal cars. Hence, the rental for a full 30-car use of the siding was $75.00. Each coal car held from 50 to 70 tons, or an average of say 60 tons. Taxpayers purchased the property, made a gift of it to a trust for the benefit of their children and leased it back agreeing to pay 7 cents a ton of coal loaded and agreed to keep the siding in good repair at their own expense. Hence the rental for a full 30-car use of the siding was $126.00 (30 cars x 60 tons x 7 cents).

Respondent's argument that the rent paid by Petitioners in 1944 was not ordinary or reasonable because of Petitioners' purchasing the property, thus superseding the Osborne lease, then making the gift and lease-back, is the same argument that he made in the *Skemp* case, namely, that Petitioners voluntarily created the then present situation. The answer given by the Court in the *Skemp* case, page 600, is equally applicable here:

> "The trustee was duty bound to exact rent of the taxpayer and the taxpayer was legally bound to pay it, just as much as if taxpayer had moved across the street into the property of a third party. No one doubts that he would have had to pay rent then, and would have been entitled to deduct it even though he had voluntarily created that situation.

> We are not impressed with the argument of the government that the taxpayer voluntarily created the present situation."

The rent paid by Petitioner herein in 1944 was just as ordinary and necessary as it was in the *Skemp* and *Brown* cases, *supra.*

2. Not only is the instant case in direct conflict with *Skemp v. Commissioner,* 168 F. 2d 598 (C. C. A. 7), and *Brown v. Commissioner,* 180 F. 2d 926 (C. C. A. 3), but it is equally in conflict with *Commissioner v. Greenspun,* 156 F. 2d 97 (C. C. A. 5), *Consolidated Apparel Co. v. Commissioner,* 207 F. 2d 580 (C. C. A. 7), *Stearns Magnetic Mfg. Co. v. Commissioner,* 208 F. 2d 849 (C. C. A. 7), and the Tax Court's decision in *Albert T. Felix,* 21 T. C. 794. In the latter case, the Tax Court, page 803, treats of each of the main cases cited by Respondent (Resp. Br. 12) and distinguishes each of them. The Tax Court then turned its attention to the *Skemp* and *Brown* cases. The Tax Court had decided both the *Skemp* and the *Brown* cases in favor of the Commissioner and had been reversed in each. The Court then says at 804:

> "We think the case at bar is not readily distinguishable from the *Skemp* and *Brown* cases, *supra.* Accordingly, we adopt the view expressed by the appellate courts and hold that the rental payments constitute ordinary and necessary business expenses. . . ."

Thus, the Tax Court has fallen into agreement with the Third, Fifth and Seventh Circuits, leaving only the Ninth Circuit in the instant case in disagreement. The same distinction which the Seventh Circuit made in *Ingle*

Coal Corp. v. Commissioner, 174 F. 2d 569, 572 (Resp. Br. 16), is equally applicable here. In the instant case, as in *Skemp* and *Brown,* the taxpayers transferred the property to an independent fiduciary acting under the authority, control and jurisdiction of an independent court, taxpayers retained no control and consequently "there was a change in the taxpayer's economic status."

3. It is submitted that there has been "very exceptional showing of error" in the instant matter.

Conclusion.

For the reasons set forth in the petition and herein, the petition for a writ of certiorari should be granted.

Respectfully submitted,

LLEWELLYN A. LUCE,
LLOYD G. RAINEY,
J. EVERETT BLUM,
Counsel for Petitioners.